

**Prepared Statement of Michael F. Cavanagh
Council for Electronic Revenue Communication Advancement, Inc.**

Thank you, Commissioner Shulman, Deputy Commissioner Ernst and Ms. Hawkins. CERCA appreciates the opportunity to participate in this forum and is very pleased to speak today as part of the Tax Return Preparer Review. We strongly support the Review process that the Government is undertaking to understand the tax preparation industry in its many forms, to identify issues to be addressed, and to develop recommendations on how best to advance the public interest.

OVERVIEW

The Council for Electronic Revenue Communication Advancement (CERCA) was established in the early 1990s, when e-filing was in its infancy. Interestingly, the organization came into being at the suggestion of the IRS. The Government wanted a reliable group through whom it could regularly communicate with the private sector in building the nation's capacity for electronic filing, and to advance the adoption of e-filing as a core part of our nation's Voluntary Compliance tax system. Today CERCA's membership encompasses almost the entire income tax software industry, the largest tax-preparation office chains, major banks offering financial products, and many of the major systems integration companies performing electronic tax-administration contracts for the IRS. CERCA's national conferences are attended by revenue officials across the nation and from abroad, as well as by industry, the public, and the media, as a prime forum for discussion of key issues, from operations to public policy.

Perhaps most importantly, CERCA meets with IRS officials for mutual exchange of information and insights on major issues on a regular and on-going basis. Results of this dialogue over the years have been joint efforts to advance the public interest in support of critical objectives, including the original creation of the IRS Free File Program to assist low and middle income taxpayers seven years ago, the design of IRS e-file marketing campaigns, and most recently, the creation of a Joint Security Working Group to address issues that are important to the integrity of the nation's tax system in the Internet age.

INCOME TAX PREPARATION OVERSIGHT

CERCA has carefully studied the major issues raised by the Tax Preparer Review and was pleased to accept IRS's invitation to comment today on key questions raised in the announcement of this initiative, at the Public Forums already held, and by the IRS request for public comment (Notice 2009-60).

Simply put, we believe in the highest levels and standards of compliance for all elements of the income tax “eco-system.” Achieving excellence in income tax compliance ensures not only mission fulfillment for the American tax system, but serves the best interests of the individual taxpayer. We believe these twin objectives should be our foremost goals.

To achieve these critical objectives, we believe that the IRS should create a regulatory strategy that addresses both the income tax preparation profession and the software industry. We further believe that a thoughtful strategy must recognize the substantial distinctions between in-person income tax preparation and electronic tax software tools and should address each of these segments in ways that appropriately deal with their unique characteristics.

PROFESSIONAL INCOME TAX PREPARERS

Let me turn first to the professional tax-preparation community.

In CERCA’s view, we believe that any regulatory strategy should include standards for the registration, education, testing and certification of anyone who holds himself or herself out to the public as a third-party tax preparer, whether that service is for a fee or free-of-charge as a volunteer or not-for-profit service. The reason for this uniform approach is simple. The goal is to provide the assurance of a consistently strong foundation to support taxpayer compliance in our complex income tax system.

Given the magnitude of this task, and the ready availability of expertise across the industry, the IRS should fully and directly engage the private sector in the training and testing of tax professionals, and do so according to a national rubric of standards to ensure that this oversight is uniform, disciplined and meaningful.

As a part of this overall strategy, the IRS should continue to regulate professionals who electronically file tax returns. While the e-filing process does reject many improperly prepared returns, which is a valuable checkpoint for the overall system, it is certainly not a foolproof protection. Current oversight and enforcement activities to prevent fraud should be further enhanced.

In response to questions asked by the IRS in the recent Notice, let us reiterate that there is an astonishingly wide range of individuals preparing taxes, in terms of background and qualifications, over whom there is little oversight today. As noted, CERCA endorses the idea of both continuing education and testing requirements for all professional income tax preparers in order to validate preparer competence, increase compliance, underscore the professionalism of the discipline, and provide additional assurance for the taxpayers who use their services.

CERCA further believes that, to be effective, any set of standards adopted for the tax preparation profession must also include a code of ethics. Professional accountability is essential. However, we draw a distinction between ethics and competence. While both are critically important, they are not the same thing. The tax professional who deliberately invents inaccurate information is guilty of fraud, not incompetence.

We want to ensure both competence and ethics, as, of course, the IRS does. Therefore, training and testing must specifically include standards of ethics and a code of conduct, and certification must include attestation of the individual preparer's commitment and adherence to the same. While there can never be a foolproof system that perfectly regulates human behavior, we believe the addition of a standardized Professional Integrity Certification, as part of the overall framework of oversight, can put additional emphasis and weight on the public trust embodied in the tax preparer's professional role and work.

To be effective, such a new regulatory strategy must include enforcement mechanisms to make the certifications meaningful.

What mechanism should be employed to implement the new regulation of return preparers that are at the heart of this review? CERCA believes that a Self Regulatory Organization (SRO) model would most appropriate, and serve the IRS best in the long run. Later in this paper, we focus on the appropriate regulatory mechanism for the oversight of tax software. We believe that many, and indeed most, of the principles we delineate for software would also fit well as a basis for return preparer regulation.

INCOME TAX SOFTWARE

The focus of the tax practitioner review has been, appropriately, on the tax professional. This makes good sense. However, IRS officials have also discussed the importance of tax software, which is an essential tool enabling today's tax "eco-system." We agree. Indeed, virtually every income tax professional utilizes sophisticated tax software in the performance of their work. But that only addresses the professional tax community, when in fact there is a substantial and growing proportion of American taxpayers who use Do-It-Yourself (DIY) tax software to assist them in fulfillment of their annual income tax compliance obligation. Indeed, the products and services of the US software industry have been vital to simplifying tax compliance, reducing compliance burdens, and advancing the American adoption of electronic filing as the preferred method of submitting one's annual income tax return.

We believe there are a number of comments that can be made about tax software, but it is vital to begin with an accurate overview:

Clearly, the tools of modern tax software make today's US tax system possible. The American technology industry, specifically the tax software industry, has fundamentally changed the means of compliance with our civic tax obligation. It has applied technological innovation to simplify the difficult, to make sense of the complex, to reduce the burden of work and save time, and to increase accuracy and reduce costs.

It is a testament to the enormous success of tax software that it has truly become a vital piece of the nation's tax infrastructure, that private investment and innovation of the American technology industry has truly reinvented tax compliance in this country. The intense competition that exists within the industry has not only created burden-reducing innovation, but a price environment that includes many low-cost or no-cost options.

To be sure, we know that there are disputes about the interpretation of tax law between well-intentioned advocates on different sides of highly complex questions. And indeed, interpretation of tax law has always been a complex discipline in the American income tax system, long before software even came on the scene. It is for that reason that interpretative disagreements have for many decades ended up in Tax Court, the records of which are replete with case law demonstrating the lack of perfect understanding in that tax system by government and citizens alike. But even taking the complexity of that environment into account, it is fair to say that tax preparation software has an extraordinary, and well deserved, reputation and track record for accuracy. The Government Accountability Office (GAO), in its February 2009 report entitled, "Many Taxpayers Rely on Tax Software," stressed the important role that tax software plays, while also noting the high quality of its performance as a critical tax compliance tool.

Nevertheless, the GAO concluded that the IRS should exercise oversight of tax software. CERCA agrees with this finding, although we would observe that this is now essentially synonymous with saying that the IRS needs to maintain oversight over the US tax system itself.

GAO spoke of the importance of risk assessment by the IRS in light of the critical role of software in the US tax system. Given all of the benefits and improvements that software has brought to both the administration of and compliance with our income tax system, it is CERCA's view that risk assessment by IRS must take a strategic approach that is focused and standards-based in order to advance the public interest without stifling either future innovation or the vitality of the competitive market that produces it. Conversely, software that would be actually or effectively written by the government would risk the unintended consequence of damaging both innovation and competition in this tax software. Moreover, the technology industry represents a core capability in today's income tax system to be able to respond very quickly and highly effectively to changing tax laws, regulations and Government initiatives and time-sensitive requirements that need rapid action and ubiquitous implementation. The tax system, the taxpayer, and the American economy would all lose in any scenario that had the practical effect of constraining limiting or disabling the capabilities of that asset.

Identifying the critical areas for standard-setting will be of foundational importance in developing a solid strategy. When the GAO discussed standards, they noted some of these critical areas which must have priority focus and highlighted security. We agree. Indeed, as we mentioned earlier, CERCA is working with IRS on beginning a joint working group on Security that will be created under the auspices of ETAAC. In recent weeks CERCA was called upon by IRS to nominate highly credentialed candidates for this new IRS/Industry Joint Security Working Group. That group is expected to be named shortly and begin operation.

We believe that this public-private partnership approach to working on security issues should achieve significant shared understanding and strides in terms of protection of the taxpayer. CERCA also believes that this strategic approach can also assist in examining, and then dealing with, other key issues facing IRS and the industry.

Another area of critical standard-setting is privacy, and here the IRS has a long track record of public policy which is expressed through Rule 7216, which is the toughest privacy regulation in the country, surpassing that promulgated by any other part of government over any other industry.

What does not exist today is a structured activity that pulls together and coordinates all existing elements of the regulatory framework, and applies them in a manner that can consistently ensure accountability and certifies compliance. Given the important role of software in today's income tax system along with the growth of Online do-it-yourself tax preparation and continued innovations throughout the tax software industry, we believe that a new joint working group should be created between the Government and the tax software industry under the auspices of the Electronic Tax Administration Advisory Committee (ETAAC). This working group would follow the model of the IRS/Industry Joint Security Working Group.

Such a new joint working group can identify, address and propose solutions and a framework for key objectives talked about in the GAO report to ensure proper tax software oversight by the IRS. This methodology would represent a strategic approach that would bring the right private and public expertise to bear in significant and meaningful ways, not only to exchange information and ideas but also to develop solutions. And of course, ETAAC would provide a Congressionally chartered vehicle for this important work so that it would be fully compliant with the Federal Advisory Committee Act (FACA).

We would also strongly urge that the new Software Joint Working Committee we are proposing today also examine and develop concepts necessary to form an appropriate and effective Self Regulatory Organization mechanism, or SRO. Such an SRO is our recommended long-term solution for tax software oversight, to ensure the objectivity necessary for income tax software to continue to enjoy the confidence of the government, tax professionals and individual taxpayers alike. Likewise, such a Joint Working Committee would provide a mechanism going forward for

the continuing exchange of information, ideas and problem-solving to address issues that arise over time once the SRO is established and operating. The Joint Working Committee would thus serve as an on-going adjunct to the SRO structure, as a vehicle for the IRS and the technology industry to continue constructive collaboration on oversight issues and needs.

There are many issues which must be explored to develop an SRO best suited to the regulatory task ahead. Some existing SRO models operate at very high cost for very large industries. Other models are less costly and less complex, which can be important in an industry with many small businesses as characterized in the Internet world. There are already elements of regulation in place today, but no oversight framework for their application and governance. Our shared challenge will be to identify all of the disparate elements of regulation and certification which already exist in connection with the tax software industry, while identifying gaps that must be addressed. We strongly recommend that the joint working group we propose should be tasked with developing a workable SRO model and the recommended strategy for its oversight mission by a date certain. We would suggest the initial planning and recommendation phase should work on a six month timetable from the date of the working group's creation.

AN ADDITIONAL ISSUE THAT HAS BEEN RAISED

In both previous Public Forums, issues regarding Refund Anticipation Loans (RALs) have been raised. The impact of these products on tax compliance and whether they provide value to the taxpayer have been questioned.

Over 20 million taxpayers annually engage a financial institution in order to access professional tax preparation without upfront cost. Almost half of these taxpayers choose to borrow against their refunds to gain quick access to what usually amounts to their largest receipt of the year. These bank products work to bring people into professional tax preparers, whose services they may not otherwise be able to afford. The bank product customer receives significant value, gaining access to professional tax preparation, access to an account to receive their tax refund (which speeds up the receipt of the refund as compared to waiting for a paper check), and, if desired, a low, fixed finance charge to borrow the refund proceeds, in most cases for 1.07% of the loan amount, or less. It is because of this value that bank product customers have high rates of customer satisfaction and year-to-year repeat usage. These are indicators of product awareness by the consumer, and a desire for the benefits bank products bring in each individual situation.

Regarding compliance, there is nothing inherent in a RAL that gives a taxpayer, or a tax preparer, any incentive to fraudulently claim a higher tax refund than the taxpayer deserves. To the extent that such fraudulent refund claims exist, taking away the RAL would not enhance compliance. It would simply move any fraud which may exist out of the bank product program

into the general population of returns. There is the further risk that the desire of millions of taxpayers to obtain the amount of their tax refund quickly would then be at risk to be fulfilled by unregulated loan sharks. In fact, such “refund discounters” were prevalent before the advent of electronic filing and regulated refund loans. Moreover, bank underwriting of RAL requests often identifies suspicious activity not seen by the IRS. The bank product industry makes a practice of sharing that information with the IRS, in many cases returning refunds the IRS should not have funded. Taking away this additional integrity filter will not improve tax compliance, nor otherwise benefit our tax system. In fact, quite the opposite may occur.

We felt it was important to directly address some of the issues and assertions that have been raised regarding the products of the banking industry, and the role they play in today’s income tax system. As with all of the issues we address in this testimony, we will be pleased to offer further discussion of these topics if that would be of assistance as the Service continues its work under the Tax Preparer Review.

CONCLUSION

In conclusion, we at CERCA believe that this Tax Preparer Review is a very important undertaking in furtherance of the public interest. We hope and believe it will lead to constructive steps forward by the IRS, tax preparers, and tax software developers, to work together to make our Voluntary Compliance income tax system even more responsive to the needs of the American taxpayer, and to the future needs of tax administration.

In this testimony we have commented on a range of key issues, and in summary, our major recommendations are:

1. To achieve the goals of this important review, we believe that the IRS should establish a regulatory strategy that addresses both the income tax preparation professional and the software industry.
2. CERCA believes that any regulatory strategy for tax preparers should include standards for the registration, education, testing and certification of all third-party tax preparers.
3. We agree with GAO that increased assessment and oversight of the tax preparation and technology eco-system would benefit the US income tax system.
4. We believe both in the case of tax preparers and the tax software industry, that an appropriate regulatory model would be a Self Regulatory Organization (SRO).

We look forward to continuing to participate in this process, and to assisting the IRS in this important task. We pledge our continued commitment to this critically important undertaking and to work for the fulfillment and success of its mission and vital public interest objectives.